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In The
SUPREME COURT OF THE UNITED STATES
October Term, 1993

NORTH CAROLINA ASSOCIATION OF ELECTRONIC TAX FILERS, INC. AND ROCKET REFUND,
Petitioners,

v.

WILLIAM T. GRAHAM, COMMISSIONER OF BANKS, NORTH CAROLINA BANKING COMMISSION,
Respondent.

On Petition For A Writ of Certiorari to the Supreme Court of North Carolina

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BRIEF IN OPPOSITION

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BRIEF IN OPPOSITION

STATEMENT OF THE CASE

A. PROCEEDINGS BELOW

The petitioners filed their complaint in the Superior Court of Wake County, North Carolina, on January 2, 1992. The petitioners sought to enjoin the respondent, the North Carolina Commissioner of Banks, from enforcing the North Carolina Refund Anticipation Loan Act, N.C. Gen. Stat.

§ 53-245 *et seq.* The petitioners contended that the Act was unconstitutional because it violated the Supremacy Clause and the Commerce Clause of the U.S. Constitution.

The petitioners' motion for a preliminary injunction was denied on January 8, 1992. The petitioners then moved for summary judgment and a permanent injunction. On February 14, 1992, the Superior Court denied the petitioners' motion for summary judgment and awarded summary judgment to the Commissioner of Banks.

The petitioners appealed and petitioned for discretionary review by the Supreme Court of North Carolina. The North Carolina Supreme Court granted discretionary review. On May 7, 1993, the Court filed its opinion, unanimously holding that the North Carolina Refund Anticipation Loan Act does not violate the Supremacy or Commerce clause of the U.S. Constitution. *N.C. Association of Electronic Tax Filers, Inc. v. Graham,* 333 N.C. 555, ___S.E.2d _____.

The petition for a writ of certiorari was filed on September 7, 1993 and was received by the respondent on September 9.

B. FACTUAL BACKGROUND

The North Carolina Refund Anticipation Loan Act, N.C. Gen. Stat. §§ 53-245 to 53-254, was enacted by the N.C. General Assembly in 1990, with an effective date of October 1, 1990. The Act represented a legislative initiative to give the N.C. Commissioner of Banks some regulatory

oversight over the marketing of consumer loans which are secured and repaid by future tax refunds. The Act requires those who offer and arrange refund anticipation loans ("RAL's") to register with the Commissioner of Banks and to make specified disclosures to consumers regarding the costs and time frames for the loans. The Act does not regulate rates but does prohibit unconscionable fees.

The Act was the result of a deliberative legislative process involving input and cooperation from representatives of the tax preparation industry, banks, state regulators, low-income consumers and the Internal Revenue Service. In 1991, over 400 refund anticipation loan offices were registered by the Banking Commissioner's office. At the time the plaintiffs' lawsuit was filed at the beginning of the 1992 tax return season, over 500 applications were pending at the Commissioner's office.

The recent growth of refund anticipation lending is largely due to the advent of electronic filing of federal tax returns. Through electronic filing, a taxpayer can file a "paperless" return with the IRS using computer access. If a refund is due, the IRS can electronically deposit the return in the taxpayer's designated bank account, usually within 2-3 weeks of filing the return. Taxpayers can and do file returns electronically without applying for refund anticipation loans.

A refund anticipation loan is a short-term, high interest consumer loan that is repaid with the proceeds of the borrower's tax refund. In the typical transaction, the RAL facilitator (which could be a tax preparer, a convenience

store or a pawn shop) takes tax return information and a loan application from the consumer. The facilitator arranges for the electronic transmission of the tax return to the IRS and the transmission of the loan information to a lending institution that issues RAL's. (The transmission is often handled by a separate service bureau since many RAL facilitators do not have their own electronic filing capacity.) If the loan is approved, the consumer can pick up his loan check from the facilitator in 3-5 days. The loan proceeds will be in the amount of the anticipated tax refund, less fees and finance charges. The loan is repaid when the actual tax refund is transmitted to the consumer's "deposit account" at the lending bank, usually within 2-3 weeks.

The North Carolina Refund Anticipation Loan Act regulates the RAL originators or "facilitators" who typically handle the solicitation, application and information transmittal for RAL's and often disburse the loan proceeds to the borrower. The facilitator is the local entity which has the only direct contact with the consumer borrower in the RAL process.

REASONS WHY THE WRIT SHOULD NOT BE GRANTED

Allowing the writ of certiorari is not appropriate in this case. The petitioners' constitutional claims are insubstantial and are based on erroneous factual premises.

The North Carolina Supreme Court thoroughly reviewed the petitioners' constitutional challenges to the North Carolina Refund Anticipation Loan Act ("RAL Act")

and upheld the constitutionality of the Act. The Court concluded that 1) there was no evidence of a federal statutory or regulatory scheme to preempt state legislation on RAL's; and 2) the Act serves an important local purpose while imposing only an incidental burden on interstate commerce. In reaching its conclusions, the Court correctly applied precedent from U.S. Supreme Court decisions on preemption and interstate commerce. Despite the petitioners' contentions, there is no conflict between the North Carolina Supreme Court's decision and any decision of this Court.

Before reaching the constitutional issues in this case, it is essential to recognize that the RAL Act does not regulate the electronic filing of tax returns. It regulates only those who solicit or arrange tax refund anticipation loans. The relationship between refund anticipation loans and the electronic filing of tax returns can best be characterized as a parasitic one. The rapid development of refund antiticpation lending has been facilitated by the speed of electronic filing and electronic direct deposit but RAL's are still exclusively private sector credit transactions.

The petitioners mischaracterize the scope of the Act in order to advance their constitutional argument. For example, the petitioners assert that the N.C. RAL Act "constitutes a direct barrier to the participation by tax preparers in the national program of electronic filing of tax returns." (Petition, p. 11). The petitioners go on to claim that a tax preparer "may be approved by the Internal Revenue Service to do electronic filing, and yet be precluded from doing so by the N.C. Act." *Id.* These assertions are

wrong. A tax preparer can qualify as an electronic tax filer without any reference to the RAL Act. If the IRS approves an electronic tax filer, that person is free to electronically file returns without registering under the RAL Act. It is only when the electronic filer offers to arrange loans that compliance with the RAL Act is mandated.

I. THE NORTH CAROLINA SUPREME COURT CORRECTLY HELD THAT THE REFUND ANTICIPATION LOAN ACT DOES NOT VIOLATE THE SUPREMACY CLAUSE OF THE UNITED STATES CONSTITUTION BECAUSE THE ACT DOES NOT REGULATE OR INTERFERE WITH THE FEDERAL TAX SYSTEM.

A. Introduction: The Petitioners' Preemption Claim Is Based Upon A Faulty Premise That Disregards The Fact That Refund Anticipation Loans Are Private Loan Transactions Outside The Scope of IRS Regulation And Control.

The Petitioners contend that the Refund Anticipation Loan Act intrudes upon the Internal Revenue Service's exclusive jurisdiction over the federal tax system. They cite numerous decisions for the proposition that, when a federal agency has been given comprehensive regulatory authority in an area, the states are preempted from legislating in that same area. The problem with the petitioners' argument is

that the facts of this case do not apply to their preemption argument.

The simple response to the petitioners' claim is that the N.C. Refund Anticipation Loan Act does not regulate, interfere with, or intrude upon the filing, collection or refunding of federal taxes. The Act applies only to the offering and arranging of consumer loans. The IRS regulates taxation, not lending. If the state Act did impinge on the IRS's exclusive jurisdiction over federal taxation, the IRS no doubt would have protested loudly. However, the record in this case contains an affidavit from the North Carolina District Director of the IRS in which he states that the IRS has no quarrel with the Act. Internal Revenue Procedure 90-62, which was the sole basis for the petitioners' preemption claim, also clearly states that the IRS has "no involvement" with refund aniticipation loans. Revenue Procedure 90-62, Sec. 10.01, *Handbook for Electronic Filers*, p. 94 (July, 1991). The current version of this Revenue Procedure, Rev. Proc. 93-8, contains the same language disclaiming regulatory interest over RAL's.

The petitioners blur the distinction between the electronic filing of tax returns, which is a procedure exclusively governed by the IRS, with refund anticipation loans, which are private commercial transactions not controlled by the IRS. It is important to recognize that a tax service or other entity can offer electronic filing of tax returns without compliance with the Refund Anticipation Loan Act and without any oversight by the Commissioner of Banks. A taxpayer can have his federal return electronically

filed and his refund direct deposited into his bank account within two to three weeks without a loan and without the Refund Anticipation Loan Act coming into play.

B. THERE IS NEITHER PERVASIVE FEDERAL REGULATION OF THE FIELD OF REFUND ANTICIPATION LENDING NOR ACTUAL CONFLICT BETWEEN THE STATE REFUND ANTICIPATION LOAN ACT AND THE FEDERAL ADMINISTRATION OF THE TAX SYSTEM.

The preemption doctrine has been set forth in a number of modern decisions of this Court, beginning with *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947). The North Carolina Supreme Court correctly summarized the current test, citing the following passage from *R.J. Reynolds Tobacco Co. v. Durham County*, 479 U.S. 130, 140 (1986):

> In determining whether Congress has invoked this pre-emption power, we give primary emphasis to the ascertainment of congressional intent. This may be manifested in several ways. Chief among the indications of an intent to pre-empt is where Congress has legislated so comprehensively that it has left no room for supplementary state legislation. Pre-emption may also be found where state legislation would impede the purposes and objectives of Congress. In undertaking this analysis, however, we must be mindful of the principle that "federal regulation of a field of

> commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons--either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained."

The petitioners contend that they have satisfied both the "field preemption" and "conflict preemption" tests. They argue that the federal government has occupied the field by comprehensively regulating refund anticipation loans and that the Refund Anticipation Loan Act imposes an obstacle to the Internal Revenue Service's ability to accomplish its congressional mandate.

The petitioners' basic argument is that because RAL's touch upon an area regulated by the IRS, any state regulation of them is preempted. Since there is no mention of preemptive intent regarding RAL's in the federal tax code or regulations, the petitioners depend on an inference of preemption from the brief discussion of RAL's in one section of an IRS Revenue Procedure.

A well-established line of Supreme Court cases, however indicates that there is strong presumption against a finding of preemption. As the Court stated in *New York State Dept. of Social Services v. Dublino,* 413 U.S. 405, 413 (1973):

> This Court has repeatedly refused to void state statutory programs, absent congressional intent to preempt them..."It will not be

> presumed that a federal statute was intended to supersede the exercise of the power of the state unless there is a clear manifestation of intention to do so. The exercise of federal supremacy is not lightly to be presumed." (citation omitted).

The presumption against preemption is particularly compelling if the area is one traditionally regulated by the states. *California v. Arc America Corp.*, 490 U.S. 93, 101 (1989). Regulation of consumer credit and protection against deceptive trade practices are, of course, matters of traditional state concern. Absent a clear and unambiguous congressional mandate to the contrary, the assumption is that the historic police powers of the states are not to be superseded by federal legislation. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. at 230; *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 146 (1963). The party claiming preemption has the burden of demonstrating, with specificity, the federal intention to preempt. *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238 (1984).

The mere fact of some federal regulation of an area does not lead to a finding of preemption. Federal and state regulations over the same area, particularly in commerce, can and do co-exist. The test is "whether both regulations can be enforced without impairing the federal superintendence of the field, not whether they are aimed at similar or different objectives." *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. at 142. See also *California Coastal Commission v. Granite Rock Co.*, 480 U.S. 572,

582-583 (1987). (Intent to preempt in federal regulations must be stated "with some specificity.")

The instant case does not require a sophisticated application of the preemption doctrine. The facts simply do not support a preemption claim. There is no pervasive federal regulation of refund anticipation loans nor is there a "clear and manifest" congressional or regulatory intent to "occupy the field."

The petitioners have not pointed to any express congressional intent with respect to refund anticipation loans because there is none. There is no federal statute that even mentions refund anticipation loans. The only federal statutory authority petitioners cited in the proceedings below was 26 U.S.C. § 6011(e) which simply authorizes the Secretary of Treasury to prescribe "regulations providing standards for determining which returns must be filed on magnetic media or in other machine-readable form." The petitioners now cite federal statutes and regulations governing third party tax preparers, e.g., 26 U.S.C. §§ 6694-6696. However, these statutes and regulations have nothing to do with refund anticipation loans. One does not have to be a tax preparer to arrange refund anticipation loans and one can register as a RAL facilitator under the N.C. RAL Act without having any tax preparation expertise.

The only specifically relevant authority for the petitioner's claim of pervasive federal regulation is found in

Revenue Procedure 93-8 (effective January 1, 1993).[1] Of course, IRS Revenue Procedures do not have the force and effect of the Internal Revenue Code or Treasury Regulations. They are intended to provide informal guidance to the public. See *Caterpillar Tractor Co. v. United States*, 589 F.2d 1040, 1043 (U.S. Ct. Cl. 1978). Revenue Procedure 93-8 contains guidelines for participation in the electronic filing program and includes one section (Sec. 10) relating to refund anticipation loans. That section does have some minimal regulations for electronic filers who arrange RAL's. These pertain to legitimate IRS tax concerns, including a requirement for consent by the taxpayer for disclosure of tax refund information to the RAL lender and a prohibition on guarantees as to the date or amount of the tax refund.

Section 10.01 also clearly states:

> The Service has no involvement in RALs. This is a contract between the taxpayer and the lender.

This statement is hardly a clear manifestation of federal intent to occupy the field of regulating tax refund anticipation lending. It falls far short of any Supreme Court test relating to preemptive intent. By itself, it ought to be sufficient to

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[1] In the proceedings below, the petitioners relied on Rev. Proc. 90 62 which was superseded by Rev. Proc. 91-69. The North Carolina Supreme Court reviewed Rev. Proc. 91-69 in its opinion. The current version, Rev. Proc. 93-8, is substantially similar to the prior versions, especially in its disclaimer of regulatory intent over RAL's.

end the inquiry and put to rest the petitioners' overblown attempts to create a preemption case.

The petitioners' other preemption claim -- that the N.C. Act stands as an obstacle to the accomplishment and execution of the full purposes and objectives of the Internal Revenue Service -- is also deficient in its basic premise. The IRS has a legitimate objective in assuring an efficient process of tax filing, including electronic filing. The state RAL Act does not interfere with this objective because it does not impose any regulations or qualifications on tax return filing. It is difficult to see how simple registration and minimal consumer disclosure requirements for RAL facilitators impede the IRS.

The record contains affidavits of the present and former North Carolina District Directors of the Internal Revenue Service. Both affidavits show that the IRS does not regard the N.C. Act as an impediment to any aspect of the internal revenue system. The petitioners' argument is directly refuted by the following statement of District Director J.R. Starkey:

> Neither that statute [the RAL Act] nor the administration of it by the North Carolina Commissioner of Banks has interfered with the Internal Revenue Service's electronic filing program. It appears that the statute has not hindered or impeded electronic filing and is not inconsistent with the Internal Revenue

> Service's goal of a smooth and efficiently run electronic filing program.

In fact, as Mr. Starkey's affidavit states, North Carolina led the nation in numbers of electronically-filed returns in tax-filing year 1991 (the first year the RAL Act was in effect).

The petitioners' preemption argument does not comport with the factual setting of this case. The petitioners have attempted to advance a regulatory position on behalf of the IRS when the IRS has clearly rejected that position. The respondent agrees with the petitioners' contention that the IRS has the exclusive control over the manner of filing federal tax returns. But this case is not about taxation, it is about refund anticipation lending. Clearly, there is no national comprehensive regulatory scheme over refund lending as petitioners claim. North Carolina is free to act in this area, as it traditionally has acted in the area of consumer credit, and the minimal requirements of the RAL Act are a legitimate exercise of legislative authority.

II. THE NORTH CAROLINA SUPREME COURT CORRECTLY HELD THAT THE REFUND ANTICIPATION LOAN ACT IS A LEGITIMATE EXERCISE OF NORTH CAROLINA'S POLICE POWER WHICH IMPOSES A MINIMAL BURDEN ON INTERSTATE COMMERCE.

A. The Refund Anticipation Loan Act Does Not Regulate Or Interfere With The Operation Of Out-of-State National Banks.

The N.C. Supreme Court thoroughly reviewed and properly dismissed the petitioners' Commerce Clause argument. The Court found that the Act furthered important state objectives. These included consumer protection disclosures to ensure that taxpayers know: 1) the difference between an RAL and a tax refund; 2) that tax returns can be filed electronically without a loan transaction; and 3) the true costs of an RAL. The Court held that the Act did not directly regulate interstate commerce and that it did not favor in-state over out-of-state economic interests. Finally, the Court concluded that as a simple registration and disclosure statute, the Act imposed only a minimal burden on interstate commerce. The Act, therefore, met this Court's interstate commerce test set forth in *Brown-Forman Distillers Corporation v. New York State Liquor Authority*, 476 U.S. 573, 578-79 (1986).

The petitioners argue that the RAL Act regulates and significantly interferes with national banking transactions

outside the borders of North Carolina. There are several serious flaws to the petitioners' claim. First, the RAL Act does not regulate national banks. In fact, banks are expressly exempt from the Act's coverage. N.C. Gen. Stat. §§ 53-247(c) and 53-254.

Second, the petitioners are not banks. They do not have standing to assert the legal interests of non-party national banks. If the legal or economic interest of out-of-state national banks were seriously affected, surely those banks would have pressed their claims directly.

Third, there is no requirement of national uniformity in the area of refund anticipation lending. No federal banking statutes address refund anticipation loans. As with consumer credit regulation generally, regulation of RAL's is appropriately a matter for individual states. The North Carolina Consumer Finance Act, N.C. Gen. Stat. § 53-164 *et seq.* (which regulates small loans under $10,000) and the North Carolina Retail Installment Sales Act, N.C. Gen. Stat. § 25A-1 *et seq.* (which regulates retail credit) are examples of typical consumer credit statutes common to most states. The RAL Act fits within this well-established tradition among the states of protecting consumers from oppressive credit practices.

Fourth, there is absolutely no support in the record for the proposition that the Act has served as a "substantial impediment" to interstate lending transactions (Petition, p. 46). In fact, it appears that refund anticipation lending has prospered in this state. The petitioners' contention that the

regulatory authority given the Commissioner of Banks by the Act "directly infringes on the ability of national banks to sustain themselves by engaging in regional and national lending" (Petition, p. 51) is ludicrous. The petitioners have not produced any evidence of any negative impact the RAL Act has had on any national bank.

B. THE REFUND ANTICIPATION LOAN ACT DOES NOT INTERFERE WITH THE UNIFORM OPERATION OF THE FEDERAL TAX SYSTEM.

As an additional Commerce Clause argument, the petitioners contend that the RAL Act undermines the uniformity of the federal tax system. Citing *Cooley v. Board of Wardens*, 53 U.S. 299 (1851) and *Southern Pacific Co. v. Arizona*, 325 U.S. 761 (1945), the petitioners correctly state that where there is federal regulation of an area of commerce, and a need for uniformity of regulation, the states should not interfere.

The respondent agrees with the petitioners that there is a need for uniform federal regulation of federal taxation, free from state interference. However, as discussed above, the state RAL Act does not regulate federal taxation. Nor, as IRS Revenue Procedure 93-8 makes clear, does the IRS claim exclusive regulatory authority over RAL's. Where there is no federal exclusivity, and no state interference with the federal domain, there can be no Commerce Clause problem.

Secondly, federal taxation is not commerce. The petitioners' attempt to bootstrap a Commerce Clause

argument on the exclusivity of federal tax regulation must therefore fail. Refund anticipation lending is commerce. However, there is no uniform system of federal regulation (or any federal regulation) of refund anticipation lending.

CONCLUSION

For the foregoing reasons, the petition for certiorari should be denied.

Respectfully Submitted,

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